

**Performance Audit  
Controls Over TIF Expenditures**

September 2003

**City Auditor's Office**

**City of Kansas City, Missouri**

September 30, 2003

Honorable Mayor and Members of the City Council:

This performance audit of tax increment financing (TIF) expenditures focuses on the TIF Commission's controls over use of redirected tax dollars. TIF is intended to encourage real estate development or redevelopment to reduce or eliminate blight and other adverse conditions in a specific area. The premise is that improvements to the area generate additional tax revenue, a portion of which is made available to reimburse developers for approved project costs.

Despite previous recommendations from this office and its own external auditor, the TIF Commission has not established basic internal controls to safeguard, manage, and account for the public dollars for which it is responsible. More than \$7 million in developer expenses approved for reimbursement by the Commission in fiscal year 2002 were either unsupported or supported with inadequate documentation. We found one certification that was based on documentation used for a prior reimbursement, and certifications for ineligible costs or for costs not actually incurred. Our findings raise serious concerns about developer reimbursements in prior years and about the \$228 million that the TIF Commission has approved but not yet paid to developers.

In addition, about \$416,000 in TIF-related bond disbursements made in fiscal year 2002 were not reviewed or approved by the Commission. More than \$357,000 of this amount was unsupported by adequate documentation.

In fiscal year 2002, more than \$1 million was transferred by the TIF Commission to the Economic Development Corporation for undocumented expenses. We also identified underpayments to Kansas City and Clay County totaling more than \$3 million.

It is unclear what TIF has purchased with redirected tax dollars. The Commission has not classified developer costs into meaningful categories to summarize and analyze expenditures. Missing and inadequate documentation also limits the usefulness of the information that is available. Based on our review of developer certifications and bond disbursements for fiscal year 2002, about 55 percent of total dollars were for construction and demolition, 14 percent for environmental reclamation and remediation, 10 percent for professional services, and 9 percent for developer interest, financing, and return on equity.

The City Council should adopt a policy regarding reimbursable expenses. The policy should provide direction to the Commission on issues such as whether redirected tax dollars should be used to pay

developers interest on costs that have been certified but not yet paid; whether redirected tax dollars should guarantee a rate of return, or profit, to developers; how to differentiate between developer expenses and public costs; and the extent of the Commission's authority to reimburse developers for costs in excess of those approved by the City Council.

The Commission and its staff need to establish effective oversight and control of public revenues. The City Manager should require that the city's annual contract with the Economic Development Corporation establish processes and strengthen the internal control environment of the Commission. If the Economic Development Corporation is unable to develop an internal control system adequate to protect the public's interests, the City Council should consider providing administrative support for the Commission through city departments under the direct control of the City Manager.

A draft of this report was sent to the Director of the TIF Commission, the President and Chief Executive Officer of the Economic Development Corporation, and the City Manager on August 15, 2003. Written responses are appended. We appreciate the courtesy and cooperation extended to us by city, TIF Commission, and Economic Development Corporation staff members throughout the audit. The audit team for this project was Deborah Jenkins, Sharon Kingsbury, Robin Reed, Amanda Noble, and Nancy Hunt.

Mark Funkhouser  
City Auditor

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# Performance Audit: Controls Over TIF Expenditures

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## Introduction

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## Objectives

This performance audit of tax increment financing (TIF) was conducted pursuant to Article II, Section 13 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the City Auditor's primary duties.

A performance audit is an objective, systematic examination of evidence to independently assess the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making.<sup>1</sup> This audit was designed to answer the following questions:

- Are controls adequate to ensure TIF money is properly disbursed and accounted for?
- What have TIF revenues purchased?

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## Scope and Methodology

This audit focuses on tax increment financing (TIF) expenditures and management's controls over those expenditures. We reviewed the \$31 million in developer reimbursement requests that the TIF Commission approved in fiscal year 2002. We also reviewed \$7.7 million in bond disbursements made in fiscal year 2002. The requests and disbursements were related to 10 plans.<sup>2</sup> In fiscal year 2002, there were 42 TIF plans.

The audit was performed in accordance with generally accepted government auditing standards. Methods included:

- Reviewing applicable state statutes.

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<sup>1</sup> Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office, 1994), p. 14.

<sup>2</sup> Our review included all eight plans for which the TIF Commission approved cost certifications in fiscal year 2002. Our review included a ninth plan for which only bond proceeds were disbursed in fiscal year 2002. (Two of the original eight plans also received some bond proceeds in fiscal year 2002.) Finally, our review included a tenth plan that had costs approved for payment from other public funds.

- Interviewing TIF Commission and Economic Development Corporation (EDC) staff.
- Interviewing city staff in the City Planning and Development, Finance, and Public Works departments.
- Reviewing selected TIF plans, amendments, development agreements, annual reports, and other documents.
- Analyzing TIF Commission and city financial records.
- Attending meetings of the TIF Commission.
- Reviewing the 2002 audit and management letter for the TIF Commission.
- Interviewing representatives of the CPA firms that do cost certifications for the TIF Commission.
- Reviewing certified developer expenses and other disbursement records.

No information was omitted from this report because it was deemed privileged or confidential.

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## **Background**

The city uses tax increment financing (TIF) as an incentive to encourage real estate development and redevelopment. TIF is intended to reduce or eliminate adverse conditions in an area and to enhance the tax base. TIF is authorized by state statute, created by the city, and administered through the TIF Commission (Commission).

Tax increment financing is based on the premise that if an area of the city is improved, it will generate additional tax revenues. The additional tax revenues can then be used to reimburse developers for approved project costs, creating an incentive to developers, or to pay off bond debt incurred to finance development.

To establish a TIF area, the City Council must find that there are no prospects for development and growth in property values, and that, “but for” the use of TIF, the development would not take place and the increase in tax revenues would not occur.

State statute defines three designations under which TIF can be used: blighted, conservation, and economic development. Different rules apply based on the designation. (See Exhibit 1.)

#### Exhibit 1. Designations for Use of TIF

**Blighted.** An “area which, by reason of the predominance of defective or inadequate street layout, unsanitary or unsafe conditions, deterioration of site improvements, improper subdivision or obsolete platting, or the existence of conditions which endanger life or property by fire and other causes, or any combination of such factors, retards the provision of housing accommodations or constitutes an economic or social liability or a menace to the public health, safety, morals or welfare in its present condition and use.”

**Conservation.** An area in which at least 50 percent of the buildings in the area are at least 35 years old and the area is at risk for becoming a blighted area.

**Economic Development.** An area in which there must be a finding that TIF will not be used to compete unfairly for tax base and that the economic-development activities are in the public interest because they will discourage commerce, industry, or manufacturing from moving to another state, result in increased employment, or preserve or enhance the municipal tax base.

Sources: Missouri Revised Statutes § 99.805(1), § 99.805(3), and § 99.805(5).

#### Roles and Responsibilities

TIF is authorized by state statute.<sup>3</sup> The statute describes how a municipality may create a TIF commission and use TIF. It defines the powers that a city and a TIF commission may use to encourage redevelopment. The statute requires annual reporting on each TIF plan and project to the Missouri Department of Economic Development.

**City Council.** The City Council creates the TIF Commission, designates redevelopment areas, and approves redevelopment plans and projects. The City Council also approves the City Planning and Development Department’s annual agreement with the EDC and the Commission.

**Tax Increment Financing Commission.** The TIF Commission is a public governmental body created by city ordinance<sup>4</sup> under the authority granted to the city by the state. The Commission is composed of six members appointed by the Mayor with the consent of the City Council, two members appointed by the county in which a project is located, two

<sup>3</sup> Mo. Rev. Stat. § 99.800 to 99.865.

<sup>4</sup> Ordinance 54556, November 24, 1982.

members appointed by the school boards whose districts are included within the redevelopment area, and one member appointed to represent all other affected taxing jurisdictions. The Commission reviews proposed plans and projects for recommendation to the City Council. The Commission enters into agreements with developers to implement redevelopment plans, monitors progress on approved projects, and reimburses developers with TIF revenues.

The state statute gives the Commission a number of powers, subject to City Council approval. The Commission may enter into contracts, purchase or lease property, acquire property through eminent domain, construct buildings and infrastructure, and issue obligations.

The Commission is supported with redirected tax dollars provided under provisions of agreements between the Commission and developers, and with city support under an agreement between the city, the EDC, and the Commission. As a public governmental body, all moneys flowing through the Commission are public funds.

**Economic Development Corporation.** The Economic Development Corporation (EDC) is an umbrella organization that provides staff support for the TIF Commission and other statutory agencies. There are five full-time staff positions assigned to administer Commission activities. In addition, other administrative, accounting, and business development staff at the EDC sometimes work on TIF-related activities.

The EDC is funded in part by the city. The City Planning and Development Department enters into an annual agreement with the EDC and the TIF Commission that requires the EDC to provide staff and administrative support to the Commission. The Commission pays the EDC for expenses incurred on behalf of the Commission, and provides general operating funds to the EDC.

### **TIF Process**

The TIF Commission holds public hearings on proposed plans and projects and makes a recommendation to the City Council. The City Council considers approval of a TIF plan to redevelop an area as well as specific redevelopment projects within the plan.

When the City Council approves a project, the area is designated as a TIF area, and its property tax base is “frozen” for purposes of regular tax collections by the city, the school districts, the county, and any other taxing jurisdictions.

The developer constructs the project, thereby increasing the value of the real property. The additional property taxes that would be due on the increased value of the property are abated. The value of the abated taxes is the "increment." The owner of the property pays property tax on the original value of the real property, and also pays the amount of the increment. Payment of the increment is called a "payment in lieu of taxes" (PILOT) instead of property tax. The increment amount paid by the property owner is used by the TIF Commission to reimburse developers for a portion of the project's costs, pay bond obligations, and pay for the cost of administering the TIF program. The "increment" can be used to pay redevelopment expenses for up to 23 years after a project is approved.<sup>5</sup>

Unlike most other states, Missouri law also allows increases in local economic activity taxes (EATs), such as utility, earnings and profits, and sales taxes, to be made available to fund development projects. Locally, in most TIF plans, fifty percent of the increase in EATs from the TIF area is available to reimburse developers for the cost of developing the property.

#### Exhibit 2. Definitions

Payments in Lieu of Taxes (PILOTs)	When property values increase in a TIF area, the corresponding increase (the "increment") in property taxes paid by the property owner is called a payment in lieu of taxes (PILOT). To the property owner, the difference between calling the payment a PILOT or a property tax is negligible; the amount due is the same.
Economic Activity Taxes (EATs)	As economic activities increase in a TIF area, so do tax revenues. In Kansas City, Missouri, 50 percent of the increase (the "increment") in certain economic activity taxes is typically captured for TIF use. The economic activity taxes that are available for TIF include sales taxes, earnings and profits taxes, food and beverage taxes, and utility taxes.

**Super TIF.** In Kansas City, the City Council has occasionally approved the use of so-called "Super TIF." Under a typical TIF plan, 50 percent of the local economic activity tax increment is available to reimburse eligible development costs. Under Super TIF, 100 percent of economic activity taxes generated in the TIF area can be made available to reimburse developers for eligible costs.

Specific plan provisions, recommended by the Commission and approved by the City Council, establish which redirected tax dollars will be used within a TIF area to reimburse developer expenses. Most plans

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<sup>5</sup> RSMo § 99.810.3.

use both PILOTs and EATs; however, plan provisions vary. Only a few plans are designated as “Super TIF” areas.

**Developer project cost certification process.** A developer submits reimbursement requests to the TIF Commission along with supporting documentation of the project costs incurred and paid. TIF staff review the request and send it and the documentation to an independent Certified Public Accountant (CPA) cost certifier. Two firms are under contract to verify and “certify” that the developer’s documentation supports reimbursement.

Cost certification requires the certifier to become familiar with the redevelopment plan and agreements in order to identify which costs are eligible for reimbursement. Developer reimbursement depends upon the terms of individual plans and the agreements between the TIF Commission and developers. The cost certifier requests additional documentation if necessary. The CPA provides a written report to the TIF Commission to certify that the documentation submitted by the developer supports reimbursement.

**Reimbursement approval.** The TIF Commission approves payment of certified costs. Reimbursement payments are made when revenues are available. Redirected tax revenues generated within the plan are used to reimburse development expenses and pay bond debt.

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## Findings and Recommendations

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### Summary

Poorly designed controls have permitted the misuse of public money. Of the approximately \$31 million in developer reimbursements that the TIF Commission approved in fiscal year 2002, staff could not provide sufficient support for more than \$7 million. We identified payments for ineligible costs, reimbursement for costs not actually incurred, and one payment based on documentation used for a prior reimbursement. The Commission retained more than \$1 million in redirected tax dollars to pay the Economic Development Corporation without documentation of specific expenses by plan. Bond issuance fees were also paid without review of supporting documentation. In addition, the Commission failed to return more than \$3 million due to Kansas City and Clay County until we brought the obligation to staff's attention.

The Commission has not established basic internal controls to safeguard, manage, and account for use of the public dollars for which it is responsible. The Commission has not required staff to take actions to correct control problems identified in previous audits. Commission managers do not demonstrate support for internal controls. Critical policies and procedures – including what documentation is required for reimbursement and guidelines for cost certification – are missing. Many decisions lack transparency and are influenced by knowledgeable insiders.

The growth in both the number of TIF plans and the amount of redirected tax dollars, as well as the complexity of individual plans increases risk of loss or misuse of public funds. TIF plans are unique and are intended to be flexible. However, plan documentation is incomplete and not maintained in a manner to facilitate administration. Consequently, the Commission sometimes relied on the memories of a few people to administer millions of redirected tax dollars. More than \$74 million in tax revenue has been redirected to the Commission for tax increment financing since the program began, with about \$28 million redirected in fiscal year 2002. Besides lax reimbursement procedures, lack of systematic processes have allowed significant project cost overruns and staff have not enforced developer reporting obligations.

The problems identified in our review of one year's certified costs raise doubts about previously paid reimbursements and previously certified

but unpaid costs. The Commission has approved reimbursement requests totaling \$228 million that have not yet been paid. The Commission should examine the certification files to ensure that adequate documentation and support for certification was submitted, reviewed, and maintained, before payments are made to any developer for previously certified costs. Documentation should be obtained and a complete review conducted before payments are made if adequate support is not evident. The Commission should also seek recovery of any funds previously paid that cannot be supported.

It is unclear what TIF has purchased with redirected tax dollars. The Commission has not classified developer costs into meaningful categories to summarize and analyze expenditures. Missing and inadequate documentation also limits the usefulness of the information that is available. Based on our review of developer certifications and bond disbursements for fiscal year 2002, about 55 percent of total dollars were for construction and demolition, 14 percent for environmental reclamation and remediation, 10 percent for professional services, and 9 percent for developer interest, financing, and return on equity.

The City Council should adopt a policy regarding reimbursable expenses. The policy should provide direction to the Commission on issues such as whether redirected tax dollars should be used to pay developers interest on costs that have been certified but not yet paid; whether redirected tax dollars should guarantee a rate of return, or profit, for developers; how to differentiate between developer expenses and public costs; and the extent of the Commission's authority to reimburse developers for costs in excess of those approved by the City Council.

The Commission and its staff need to establish effective oversight and control of public revenues. The City Manager should require that the city's annual contract with the Economic Development Corporation establish processes and strengthen the internal control environment of the Commission. If the Economic Development Corporation is unable to develop an internal control system adequate to protect the public's interests, the City Council should consider providing administrative support for the Commission through city departments under the direct control of the City Manager.

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### **\$3.3 Million in Payments Due to City and County Not Made**

Economic Development Corporation (EDC) staff failed to pay \$3.3 million due the city and county. Provisions in the First Amendment to the Shoal Creek TIF Plan limit the real property tax increments (PILOTs) collected in the plan area. PILOTs generated from the plan after year 2000 go back to the taxing jurisdictions. Plan provisions also require 10 percent of all economic activity taxes (EATs) collected within the plan area after 2000 to be returned to the city and county. After we brought the plan requirements to their attention, EDC staff issued checks to the city totaling \$947,905 to return real property tax revenues and checks totaling \$343,451 to cover the economic activity taxes. In addition, the EDC staff returned to Clay County approximately \$2 million in tax funds due under the Shoal Creek Plan.

The President and Chief Executive Officer of the Economic Development Corporation should establish procedures to systematically identify and promptly pay obligations due to taxing jurisdictions.

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### **\$8.6 Million Improperly Certified for Reimbursement or Paid**

The TIF Commission approved approximately \$7.3 million in developer reimbursement requests in fiscal year 2002 without adequate support. Staff relied on developers' unsupported representations, certified payments without documentation, certified expenses that were ineligible under the plan, certified reimbursements for costs not actually incurred, and reimbursed amounts before agreements were executed. In addition, staff certified a payment based on documentation used for a prior reimbursement.

TIF staff authorized approximately \$357,000 in bond issuance fees without reviewing supporting documentation. The Commission staff also transferred \$1 million to the EDC for undocumented expenses.

Redirected tax dollars are public funds intended to produce public benefits at a reasonable cost. As stewards of public funds, the TIF Commission and Economic Development Corporation staff have a duty to ensure that money is certified and paid appropriately.

### **Inadequate Documentation Accepted for Certifications**

TIF staff did not obtain or maintain documentation to support all expenses certified for developer reimbursements or bond proceeds disbursed in fiscal year 2002. Summary documents rather than contracts, invoices, and proof of payment were used to certify some developer costs. The use of minimal documentation resulted in the certification and payment of unsubstantiated expenses.

**TIF staff certified expenses without adequate support.** The Commission has virtually no documentation to support a cost certification of \$3.5 million for the Briarcliff TIF plan. An outside CPA firm was originally hired to review developer documentation supporting the reimbursement request. The outside CPA certifier reported, however, that he was removed from the assignment when he asked questions about transactions. TIF staff eventually certified costs in-house, but does not have supporting documentation. It is unclear what documents staff reviewed.

TIF staff is working with the Briarcliff developer to obtain documents to support the \$3.5 million certification. Since the original request for certification, staff for the developer has changed. A member of the developer's new staff reports that interest costs originally submitted and certified contained an error resulting in an over-certification of about \$57,000.

**TIF staff accepted summaries without supporting documentation.** TIF staff recommended certifying costs for reimbursement to developers using developer letters and summaries. Some developers were reimbursed based on the submission of developer-generated summary documents, rather than invoices and canceled checks.<sup>6</sup>

A Shoal Creek developer submitted only a letter requesting reimbursement and a list of vendors reportedly paid to support a certification request of more than \$500,000. The total amount was certified and paid, and included \$500 that had not been spent.<sup>7</sup>

**TIF staff over-relied on developer representations.** One Shoal Creek developer was reimbursed more than \$25,000 based on the submission of an unsigned copy of a title company closing statement.<sup>8</sup> TIF staff believed that the statement was documentation of loan closing costs for the acquisition of a right-of-way. The actual property involved in the

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<sup>6</sup> Shoal Creek, North Flintlock, and Chouteau.

<sup>7</sup> Shoal Creek, Shoal Creek Parkway Extension.

<sup>8</sup> Shoal Creek, North Flintlock Road.

transaction was not identified on the document, and when contacted, the title company reported that the closing statement was for loan refinancing and that the ownership of the property did not change. Although the developer incurred an expense, the basis of the fee was not clear and the documentation supporting the expenditure incomplete.

**Wrong documents were used to certify \$980,000.** When summaries are provided for certification, staff and certifiers can become confused. A Chouteau plan developer submitted a request for reimbursement that included \$980,000 in “accrued interest.” A summary document was submitted to support the request. The certifier did not review supporting documentation to verify that all expenses upon which the “interest” was calculated had been incurred, were associated with the plan, and reimbursable under the terms of the plan and developer agreements. Rather, the certifier reviewed a sample of expenditures from a second summary supplied by the developer. The certifier noted on a spreadsheet containing interest calculations totaling \$1.9 million that “Recalculated interest, appears accurate. Developer is claiming only \$980,000 on project for TIF reimbursement.”

The certifier appears to have used interest rates contained in an amended and restated promissory note as the basis of his interest calculations. Subsequent communications from an attorney representing the developer, however, suggest that 9.82 percent and not the rates contained in the note were intended to be the basis of the developer claim. Based on the documentation in the certifier’s files and subsequent communications to the TIF Commission from an attorney representing the developer, it appears that the certifier did not use the document the developer submitted in support of the \$980,000 in accrued interest claimed.

**Public Works reviews were not cost certifications.** Commission files for Shoal Creek projects showed no evidence that cost certifiers conducted an independent review of major construction costs before the Commission approved reimbursement to developers. TIF staff presented pay requests for two Shoal Creek developers to the Commission stating that “the City’s Public Works Department has reviewed this pay request and the work completed per the pay request and has given its approval.”<sup>9</sup> Public Works, however, does not review costs nor certify them for reimbursement. Public Works’ role is to conduct site inspections to verify that work is progressing and meets city standards.

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<sup>9</sup> TIF Commission meeting minutes, May 2001, June 2001, July 2001, August 2001, September 2001, November 2001, and December 2001. The January 2002 minutes also contain a similarly worded phrase, “The city’s Public Works Department reviewed and approved the pay request.”

Rather than contracts, invoices, and proof of payment, support for more than \$2.5 million in costs approved for reimbursement or as credit against the developer's initial project contribution consisted of letters, spreadsheets, and documents signed by the construction contractors, the developers' consulting engineering firms, the developers, and the Public Works Department. The developers' contractors and engineers certified that work had been completed and that payment in an amount listed was due. The Public Works' disclaimer on the submitted documents states "Public Works verification based on visual inspections and on measurements and recommendations of [the developers' consulting engineer]."

**TIF staff did not require detailed bills.** The Commission approved over \$18,000 of inadequately documented legal fees associated with one Shoal Creek project.<sup>10</sup> Billing rates and times were not provided. Support for some fees was merely the past due balance entry on a subsequent bill. Although the developer obtained legal services, without detailed bills, it is impossible to determine whether the services are a TIF reimbursable obligation.

TIF staff did not review invoices for approximately \$357,000 in bond expenses in fiscal year 2002. Only summary listings were reviewed before the payments were authorized. Some of the summaries did not provide the name of service providers, but only listed the type of service provided and an amount to be paid.

#### **Developer Costs Reimbursed Without Executed Agreements or Obligation**

TIF staff recommended reimbursement of developer project costs without written contracts and award letters. Some moneys were transferred to a developer although staff could identify no contractual obligation to make the payment.

**TIF staff recommended reimbursement before written contracts or awards were completed.** The Commission reimbursed more than \$500,000 to one Shoal Creek developer before an agreement had been drafted or executed.<sup>11</sup>

TIF staff did not always issue an award letter following the 11<sup>th</sup> Street advisory board's recommendation to the Commission to fund projects in the plan area. TIF staff could not locate attachments to award letters for

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<sup>10</sup> Shoal Creek, North Flintlock Road.

<sup>11</sup> Shoal Creek, Shoal Creek Parkway Extension project.

review even though the Commission made reimbursements based on the information the award letters and attachments contained.<sup>12</sup>

The President and Chief Executive Officer of the Economic Development Corporation should ensure that written agreements are executed before costs are certified and moneys are paid.

**TIF reimbursements made but not contractually required.** The Commission paid approximately \$10,300 in interest for funds held for a Shoal Creek developer.<sup>13</sup> The Commission staff was unable to provide a contractual obligation supporting the payment and did not apply the interest payment against other certified expenses. In another certification, the developer was reimbursed for late fees accrued on overdue bills, again, without a contractual obligation to do so.

### **Ineligible Expenses Certified**

TIF staff recommended, on the advice of counsel, an award of \$100,000 for an improvement that was not eligible under state statute or criteria established by the 11<sup>th</sup> Street Corridor advisory board. In another 11<sup>th</sup> Street Corridor award, staff recommended reimbursement of \$150,000 in expenses without identifying specific expenses and determining the eligibility of those expenses.

**A TIF award violated advisory board criteria and may have violated statutory requirements.** The 11<sup>th</sup> Street advisory board recommended \$100,000 for the Lewis and Clark statue in Case Park, even though the statue is located outside of the boundaries of the plan area. The recommendation violated the advisory board's own requirement that eligible projects be located within the boundaries of the redevelopment area or along its designated streetscapes.

The Commission's counsel initially recommended that the TIF plan be amended in order to assist this project. The Commission gave its qualified approval to the award, subject to the amendment of the plan. Although the plan was not amended to include the location of the statue, the Commission later authorized reimbursement and the award was paid.

To support this award, the Commission's counsel interpreted statutory criteria in a way not yet tested and concluded that a statue, located outside of a plan area, could be a reimbursable project cost.<sup>14</sup> While some public improvements can be so essential to the preparation of a redevelopment area that redirected tax dollars could sometimes be used

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<sup>12</sup> 11<sup>th</sup> Street Corridor plan, Folly Theater and 1015 Central projects.

<sup>13</sup> Shoal Creek, North Flintlock Road.

<sup>14</sup> Memorandum from Bryan Cave to 11<sup>th</sup> Street Corridor TIF Plan General File, July 10, 2000.

outside of a TIF area, a statue does not appear to meet the “essential to the preparation of the redevelopment area” requirement of the state statute.<sup>15</sup>

**TIF staff certified costs without identifying eligible expenses.** The TIF Commission reimbursed \$150,000 for exterior entry improvements to a property within the 11<sup>th</sup> Street Corridor plan. The entry improvements were part of a larger remodeling project. Although the recipient provided supporting documentation for the total remodeling project, the documentation did not identify which costs were related to the improvements to the exterior and covered as part of the TIF award and which were for interior changes and therefore, not covered. When asked to identify which invoices had been reimbursed, the Commission director replied, “The \$150,000 was not intended to reimburse specific invoices. The \$150,000 was awarded on the basis that the multimillion-dollar project would occur. Based upon the invoices and documentation it was determined that the multimillion dollar project had occurred and the \$150,000 was reimbursed accordingly.”<sup>16</sup>

The 11<sup>th</sup> Street advisory board’s application materials clearly state that improvements to building interiors are not eligible for reimbursement. Although the entire project included interior and exterior renovations, only exterior façade, streetscape, and parking improvements were eligible under the committee’s written criteria. An award letter, which might have provided more direction, could not be found by the TIF staff or the developer. TIF staff concluded that an award letter had probably not been issued.

In recommending that an expense incurred by a developer be reimbursed with public moneys, staff should be able to clearly identify which expenses are being reimbursed and take steps necessary to ensure that the expense is eligible under all rules, regulations, contracts, and statutes that apply.

### **Costs Certified with Inadequate Evidence**

TIF staff recommended certification of costs without evidence that costs were actually incurred. Staff also certified costs for one project based on documentation that had been previously submitted and reimbursed.

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<sup>15</sup> RSMo 99.820.1(6). “ A municipality may install, repair, construct, reconstruct, or relocate streets, utilities, and site improvements essential to the preparation of the redevelopment area for use in accordance with a redevelopment plan.”

<sup>16</sup> Memorandum from TIF Commission Director to City Auditor’s Office staff, February 14, 2003.

**A developer was credited for expenditures without evidence that all of the costs were incurred.** A Shoal Creek developer was given credit for project expenditures based on developer-generated spreadsheets showing project costs incurred. One of the spreadsheets included an entry for \$138,000 in bond and permit fees.<sup>17</sup> When we requested support for this figure, we were given five documents. Four documents supported fee amounts totaling \$52,887. The fifth document was for a Missouri Department of Transportation (MoDOT) bond, which contained the notation “on file.” MoDOT indicated that no money changed hands when this bond was issued. Although the Commission credited \$138,000 in developer expenses against the developer’s initial obligation of \$161,790, support for additional bond and permit fees totaling \$85,113 was never provided for our review.

**Same invoices were submitted and reimbursed twice.** Documentation supporting almost \$16,500 in façade improvements for one building within the 11<sup>th</sup> Street Corridor plan was submitted and reimbursed twice.<sup>18</sup> In addition, not all of the documentation was adequate to support reimbursement. Two “invoices” were actually estimates, and only hand written check stubs or check requests rather than copies of cancelled checks were submitted as proof of payment for some expenses.

### **Commission Use of Redirected Tax Dollars Was Unsupported**

In fiscal year 2002, the Commission took approximately \$1.1 million in redirected tax dollars under contract provision with individual developers. The agreements between the developers and the Commission authorize the Commission to take up to five percent of annual redirected tax revenues generated by a plan to cover reasonable and necessary Commission expenses. The Commission, however, does not document or allocate expenses to support its five percent. In 2002, over \$1 million was transferred by the Commission to the EDC for undocumented and unallocated expenses.

The expenditure of redirected tax dollars is also regulated by state statute. Under state law, redevelopment project costs include all reasonable or necessary costs incurred and incidental to a redevelopment plan or project. The framework established under the state statute is based on individual redevelopment areas. Redirected tax dollars are collected and held by plan in the special allocation fund. Surplus redirected tax dollars are required by law to be returned to taxing jurisdictions. After project costs are paid, all remaining moneys in the special allocation fund are to be paid to the

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<sup>17</sup> Shoal Creek, North Brighton.

<sup>18</sup> 11<sup>th</sup> Street Corridor plan, 1015 Central building.

county collector, and immediately paid to the affected taxing jurisdictions proportionately.<sup>19</sup>

In 1992, city and Commission attorneys reached agreement on how to handle incidental costs. Expenses directly attributable to a plan would be reimbursed and costs that were incidental to a plan would be billed based on a formula developed by the Commission. Incidental costs could be billed but in an amount not to exceed five percent annually. The Commission does not use a formula to allocate incidental costs but rather takes up to five percent of redirected tax dollars generated.

The President and CEO of the Economic Development Corporation should adopt a method of allocating incidental costs among plans. Plan revenues taken by the Commission should be documented and attributable to a particular plan. Incidental expenses allocated under a method adopted by the Commission should also be documented.

### **Public-Sector Managers Have a Duty of Stewardship**

The Commission and its managers must exercise a high degree of care in safeguarding, managing, and accounting for public assets. Public sector managers may owe a higher degree of responsibility for stewardship than private sector managers because the resources they administer are obtained involuntarily through taxation. Citizens expect public-sector managers to take every reasonable precaution to prevent the misuse of public funds.

The process used by the Commission to certify expenses for reimbursement with redirected tax dollars did not protect the public's interests. The President of the Economic Development Corporation needs to take steps to establish controls over the public moneys that flow through the TIF Commission.

The President and Chief Executive Officer of the Economic Development Corporation should employ outside certifiers to review documentation of previously certified costs and obtain additional supporting documentation where needed. Reimbursements should be tied to specific expenditures under the terms of written agreements. Certifications should be revised in those instances in which expenses are not allowed by state statute, required by the terms of the plan and executed contracts, or when documentation is not provided. Unsupported, duplicate, and ineligible reimbursements that have been paid should be recovered and repaid to the special allocation fund.

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<sup>19</sup> RSMo § 99.850.

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## **TIF Moneys Are Vulnerable to Loss**

The Commission's operating environment contains a number of factors experts have identified as contributing to high inherent risk, which could increase the Commission's vulnerability to loss if adequate internal controls are not in place. Unique plans and agreements increase complexity of operations. The volume of tax receipts and magnitude of developer reimbursements are growing. In addition, previously identified control weaknesses have not been corrected.

When assessing an organization's vulnerability to loss, experts review inherent risks and the internal control environment established to manage risks.<sup>20</sup> Among the factors that contribute to risk are:

- Complexity
- Rapid growth
- Prior internal control problems
- Unresponsiveness to identified internal control weaknesses

### **Complexity of TIF Plans and Agreements Increases Risk**

Tax increment financing is a powerful and flexible tool. Each TIF plan and project is unique. The plan documents and agreements contain varied provisions. Although the Commission has taken steps to establish some uniform provisions, plans and agreements continue to be varied and complex.

Uniqueness of plans is viewed by Commission staff as a strength of the program. However, without adequate internal controls to track the varied plan requirements and responsibilities, the result is an unpredictable and uncontrolled process. The complexity of the tax increment financing process increases the likelihood that the process will not operate as intended or comply fully with applicable laws, regulations, and contractual requirements. The lack of standard provisions complicates administration and benefits knowledgeable insiders.

### **Growing Number of TIF Plans Increases Risk**

In fiscal year 2002 there were 42 TIF plans, almost double the number of plans in 1996. As the number of plans and associated projects grows, the task of administering various contracts also grows and places additional pressures on administrative staff.

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<sup>20</sup> Stephen J. Gauthier, *Evaluating Internal Controls, A Local Government Manager's Guide*, (Chicago: Government Finance Officer's Association of the United States and Canada, 1996) pp. 20-21.

### **Growing Volume of Receipts Increases Risk**

The revenues flowing into the Commission are growing. Since the inception of tax increment financing in the 1980s, more than \$74 million in tax revenues have been redirected to the Commission for reimbursement of development project costs. Actual redirected tax revenues to the Commission were a little more than \$12 million in 1997, about \$28 million in 2002, and are projected to reach \$52 million in 2006. As the amount of revenue and number of plans grows, the task of monitoring agreements, tracking fund transactions, and safeguarding public assets also grows. The growth in receipts results in an increase in the moneys at risk if internal controls are not in place.

### **Magnitude of Developer Reimbursements Increases Risk**

In fiscal year 2002, the Commission approved developer submitted costs of more than \$31 million for reimbursement. Once developer costs are certified and approved by the Commission, reimbursement payments are made as redirected tax revenues are received by the Commission or as bond proceeds are available. The Commission reimbursed \$15.3 million in developer expenses and bond trustees disbursed another \$7.7 million in bond proceeds in fiscal 2002. Given the magnitude of expenses certified and paid to developers, it is important to ensure that reimbursements are made only for expenditures actually incurred by developers and identified as reimbursable expenses under the terms of TIF plans and contracts.

**Certified but unpaid reimbursements total almost a quarter of a billion dollars.** State statute does not guarantee that a plan or project will generate enough in redirected tax dollars to completely reimburse a developer. Our prior audit found that plan revenues were substantially below plan revenue projections.<sup>21</sup> The Commission has written down some previously certified payables because the expected performance of a plan was not strong enough to generate sufficient revenue during the agreement to reimburse previously certified developer expenses.<sup>22</sup> On April 30, 2002, at the close of the fiscal year, certified developer expenses approved for reimbursement, but not yet paid, totaled just under \$228 million.

### **Previously Identified and Uncorrected Problems Increase Risk**

Prior problems and the inability or unresponsiveness of management to correct identified problems increases the potential for bad situations to

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<sup>21</sup> *Performance Audit: Tax Increment Financing*, Office of the City Auditor, Kansas City, Missouri, September 1998, pp. 16-19.

<sup>22</sup> Hickman Mills Plan.

repeat themselves. Weaknesses in professional services contracting and apparent violations of the state Sunshine Law continue. In addition, previous external auditor recommendations regarding the cost certification process were disregarded.

**Professional services contracting continues to be a problem.** Our September 1998 performance audit of the Commission identified problems in the contracting process.<sup>23</sup> The audit recommended the Commission establish policies and procedures over professional services contracts. The Commission established policies and procedures for professional services selections, but key staff were not aware of the written policies and procedures.

Problems in Commission contracting for professional services continue. The scope of services is not established for some professional services providers, the price of a specific service is not established in writing, contractual procedures on when a contractor could proceed on a project are not followed, contractual provisions on billing are not followed, and professional services contracts expired before the request for proposal process for the next contracts was initiated.

Missouri statutes require as a general rule that a public contract must be in writing, dated, and signed by an official with authority to bind the public entity and that an executed copy of all agreements be kept in the files.<sup>24</sup>

The President and Chief Executive Officer of the Economic Development Corporation should ensure that state law is followed and execute and maintain copies of all Commission contracts. Contract terms should be established in writing and followed.

**Documentation to support payments to professionals is inadequate.** The external auditor's April 2002 management letter noted that in certain cases vendor invoices do not contain sufficient documentation to support the amount billed.<sup>25</sup> The auditor recommended that a formal policy be adopted which describes the supporting documentation required of professionals submitting an invoice for payment, including a detailed description of the services provided; the date of the services; the number of hours required to perform the services with the hourly rate charged or a reference to the consultant's contract if the services are billed at a lump

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<sup>23</sup> *Performance Audit: Tax Increment Financing*, pp. 33-39. This audit found that there were no written policies and procedures in place for professional services contracting, irregularities in contractor selection practices, contracts signed by individuals who were not authorized to enter into contracts for the Commission, no written agreements for legal services, inadequate monitoring of contracts, and payments exceeding authorized amounts.

<sup>24</sup> RSMo § 432.070 and 432.080.

<sup>25</sup> Cochran Head & Co., P.C., April 30, 2002 Management Letter, p. 4.

sum price; copies of supporting documentation for ancillary expenses; and other documentation that would provide support for payment.

The President and Chief Executive Officer of the Economic Development Corporation should direct staff to update current policies governing the Commission's professional services contracting and establish standards for documentation required to support billing for professional services.

**Sunshine Law issues continue.** The City Auditor's September 1998 performance audit also identified problems with the Commission's compliance with the state open meetings and records law (the Sunshine Law). Although the Commission adopted a written policy related to the Sunshine Law, non-compliance issues continue.

The Sunshine Law requires that all public governmental bodies maintain a record of their meetings including the date, time, place, members present, members absent, and a record of any votes taken.<sup>26</sup> The Commission's own policy contains similar requirements. Copies of all advisory committee minutes, however, were not maintained and could not be provided when requested. The minutes that were provided did not always contain the time and place of the meeting, or the members present and absent.

Meeting minutes are important records and required by the Sunshine Law. Meeting minutes allow the public to understand the intentions of the governing body and provide an accurate record of actions taken and the deliberations of public bodies.

**Meeting records that are maintained may not be accurate.** In one instance meeting minutes of the TIF Commission were found to be unreliable by Commission staff, and could not be used to justify a reimbursement for land costs.<sup>27</sup> The certifier questioned \$2.3 million in land acquisition costs submitted for reimbursement, because the original plan showed this cost would be borne by the developer and would not be reimbursable. The certifier was told that the terms of the agreement had changed to allow reimbursement of the land costs, but neither the developer nor the Commission director could provide written documentation of the change in terms. Commission meeting minutes did not support a change in contract terms. The memory of the developer and the Commission's director were the basis of establishing that the terms of the agreement had changed, overriding the written plan documents, developer agreement, and the recorded minutes of the Commission meeting. Care should be taken to ensure that the

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<sup>26</sup> RSMo Chapter 610, *Governmental Bodies and Records*.

<sup>27</sup> Tower plan, project A.

Commission and committee minutes accurately record discussions and decisions made.

The President and Chief Executive Officer of the Economic Development Corporation should ensure that commission and committee minutes are complete and accurate, and that copies of minutes are maintained.

**Recent external auditor's recommendation disregarded.** The Commission's external auditor recommended that reviewers who are independent of the Commission conduct developer cost certifications. Although the external auditor's report was not released to the public until late February 2003, the issue of cost certification was discussed with TIF staff early in the summer of 2002. The external auditor expressed concern in the April 2002 management letter that the staff person certifying developer project costs was in many cases also responsible for issuing the related check to the developer.<sup>28</sup> Despite the auditor's recommendation that certifications be conducted by reviewers independent of the Commission, TIF staff reviewed and recommended payment of approximately \$469,000 in "interest" or return on equity to the Chouteau plan developer in February 2003.

The President and Chief Executive Officer of the Economic Development Corporation should ensure that all cost certifications are conducted by independent reviewers.

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## **Safeguards and Controls Over TIF Moneys Are Inadequate**

Basic internal controls are not in place to safeguard, manage, and account for the public dollars that flow through the TIF Commission. Commission managers have not communicated or demonstrated support for internal controls. The development community, not the public, has been seen as the TIF Commission staff's primary constituency, with a developer driven, not management controlled, certification process.

The Commission does not have policies and procedures to control the submission and review of millions of dollars in developer reimbursements. In addition, the Commission has not enforced developer obligations.

Advisory committees, set up to make recommendations to the Commission, impair transparency and promote the interests of knowledgeable insiders. Budgets for TIF plans may be modified and

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<sup>28</sup> Cochran Head & Co., P.C., April 30, 2002, Management Letter, p. 3.

expanded and the amount of potential public obligation increased without discussion before or approval of the City Council.

The Commission does not operate with a budget and could not provide documentation to support expenditures of redirected tax dollars.

### **Documentation Is Incomplete and Inadequately Organized**

TIF plan documentation is incomplete and not maintained in a manner to facilitate administration. The Commission files contain fully executed agreements for only some of the plans reviewed. In addition, there were blanks within agreements, references to contract attachments were incorrect, copies of referenced attachments were not maintained in the files, and obvious drafting mistakes were found in some documents.

Written plans, contracts, award letters, and budgets identify obligations and responsibilities. The fiduciary responsibility of public managers is not met when payments are made without an established contractual obligation. A complete set of executed agreements should be maintained in an organized manner in order to properly administer and conduct the Commission's business.

The President and Chief Executive Officer of the Economic Development Corporation should ensure that copies of executed agreements and contracts are maintained in a systematic manner and are used to identify obligations and serve as the basis for reimbursements.

### **Critical Policies and Procedures Are Absent**

The Commission does not have policies and procedures to guide the review and certification of developer reimbursements. Policies and procedures are a fundamental part of a favorable control environment. They establish responsibilities and accountability, help ensure compliance, and reduce institutional risk. Policies and procedures provide clarification and guidance.

**Adequate developer documentation is not defined.** The documentation submitted by developers for expense reimbursement was not sufficient to support all of the \$31 million in claims certified for payment in fiscal year 2002. Of the documentation obtained from the Commission and certifiers' files, only two of the eight files contained complete documentation. Although some contracts contain language that requires the developer to submit adequate documentation in order to be reimbursed for plan or project expenses, there are no written guidelines either defining adequate documentation or describing how the developer is to organize documents.

The Commission's external auditor warned in the April 2002 management letter that subjective decision making could result from the lack of formal policies describing the type of documentation that is required to certify project costs. The auditor recommended that the Commission adopt a written policy detailing the type of documentation required from developers for project cost certifications and suggested that documentation could include, but would not be limited to, original copies of vendor invoices, contractor pay estimates, construction contracts, payroll registers, employee timesheets, cancelled checks, receiving documentation, project budgets, contract change orders, and contractor bids or quotations.<sup>29</sup>

The President and Chief Executive Officer of the Economic Development Corporation should prepare for Commission adoption a policy identifying the documentation that developers are required to submit for certification of reimbursable expenses and establish a standard method of organizing the submission for all certifications.

**Cost certification guidelines do not exist.** The TIF director provided a half-day of training for the two Certified Public Accountants chosen to do cost certifications. There are no written guidelines describing what cost certifiers should review or how the review should be documented. This lack of specificity has resulted in inconsistencies in how reviews are conducted and documented and may have resulted in the improper certification and reimbursement of some expenses.

**Standards for review vary among reviewers.** In fiscal year 2002 the current and former TIF directors and two CPA firms reviewed and certified costs for ten TIF plans. Four of the cost certifications reviewed were conducted by outside certifiers. The other six were reviewed and certified by TIF staff. The level of review conducted and documentation maintained varied widely.

One CPA cost certifier requested and examined documentation for every submitted expense. The certifier maintained organized copies of all documentation used for the certification, cross-referenced supporting documents to summary schedules, and provided evidence of supervisory review.

A second CPA cost certifier requested only a sample of supporting documentation. Documentation submitted by developers, or reviewed at the developers' offices, was not copied by the CPA. Only limited

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<sup>29</sup> Cochran Head & Co., P.C., April 30, 2002 Management Letter, p. 3.

documentation was maintained by the CPA to support the costs certified as reimbursable in the firm's reports to the Commission.

Documentation supporting certifications of developer costs conducted by Commission staff did not contain support for all of the expenses certified. The extent of staff review was not clear from the documentation maintained in the files.

The President and Chief Executive Officer of the Economic Development Corporation should establish a procedure describing how independent reviewers will conduct each examination of reimbursable expenses. Documentation submitted by developers and those administering the program should be maintained in a systematic manner and be available for future examination.

### **Controls on Bond Disbursements Are Deficient**

Bond proceeds are used to reimburse development expenses for some TIF plans and pay for issuance expenses. Approximately \$416,000 in bond disbursements did not go through the Commission's certification and approval process. Duties are not segregated. In addition, it is unclear who has the responsibility for reviewing developer documentation when the bonds are backed by the city and other entities.

#### **Bond disbursements were not presented for Commission approval.**

Approximately \$416,000 in bond disbursements were approved by TIF executive directors without presenting the requests to the TIF Commission for its review and approval.<sup>30</sup> The Commission's ability to carry out its fiduciary responsibility to protect public funds is hampered when complete information is not presented. The Commission should review and approve all bond proceed disbursements.

**Segregation of duties was not always practiced for bond disbursements.** Examination of the documentation maintained by TIF staff to support developer reimbursements from bond proceeds revealed that, in some cases, the same TIF staff person who reviewed developer expense documentation and approved the reimbursement also authorized the bond disbursements used to pay development expenses. Segregation of duties is a key element in a strong internal control system. No one person should have complete control over any transaction from initialization to completion. In contrast, the review and approval of millions of dollars in bond proceeds has rested in the hands of one TIF manager.

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<sup>30</sup> KCI Corridor, Chouteau, and Uptown plans.

**Responsibility for review of developer documentation is unclear.** In some instances, TIF projects may receive funding from bonds issued by the city or entities other than the Commission. Although the bond payment authorization is signed by representatives of the Commission and other entities and certifies that the costs were incurred, a clear division of responsibility for the review and approval of the payment requests has not been established. City Planning and Development Department staff who authorize disbursements from city-backed bonds said they rely on the Commission to do due diligence for non-construction expenses submitted by developers. However, Commission files did not always contain evidence that developer expenses had been reviewed and verified.

The President and Chief Executive Officer of the Economic Development Corporation should ensure that bond disbursement requests are brought before the TIF Commission and that the certification of the expenses authorized for disbursement are reviewed by an outside reviewer.

### **Developer Reporting Obligation Is Not Enforced**

The plans and individual contracts with developers contain obligations for both the developer and the Commission. However, obligations of the developers to perform basic reporting functions are not enforced. Many plans contain provisions that use economic activity taxes (EATs) to reimburse developers for costs. The Commission's EATs policy requires that a TIF developer, who sells, assigns, leases or subleases property within a project, include in the contracts and require for inclusion in any subsequent contracts, requirements for the submission of EATs documentation. A memorandum of the agreement is also to be filed as a part of the property record for all property within the TIF district in order to put subsequent takers on notice. For leased property, the developer/owner is also obligated to report annually on the entities located within the project area in order to facilitate the identification of the taxes to be used to reimburse developer and plan expenses.<sup>31</sup> This obligation is not enforced.

The Commission's external auditor found that the current TIF processes make it difficult to determine the amount of revenues due from taxing authorities.<sup>32</sup> These problems were identified in the April 2002 external

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<sup>31</sup> The *Tax Increment Financing Commission Economic Activity Taxes Policy and Procedures* (12/1/93) are incorporated by reference in agreements between the Commission and developers. Section IX states that "The developer/owner of the property shall provide to the TIF Commission on an annual basis a certified list of business (sic) within the Redevelopment Project Area."

<sup>32</sup> Cochran Head & Co., P.C., April 30, 2002 Management Letter, p. 2, and Auditor's Report on Compliance and Internal Controls.

audit and management letter as a material weakness.<sup>33</sup> The external auditor stated that there was a need for a better system of determining which businesses are located within the TIF areas and better revenue information. Enforcement of annual reporting requirements could help address the external auditor's concerns.

The President and Chief Executive Officer of the Economic Development Corporation should develop a system to track and enforce all developer obligations.

### **Advisory Committees Impair Transparency**

The use of advisory committees diffuses accountability and benefits knowledgeable insiders. Some TIF plans authorize the establishment of advisory committees to advise the Commission regarding the use and disbursement of public funds.<sup>34</sup> While developers clearly benefit from representation before and on advisory committees, it is not always clear whose interests some advisory committee members are representing.

#### **Some advisory committee members represent multiple interests.**

One member of the Shoal Creek advisory committee, who was appointed to represent a public entity, identified himself as a paid professional for a developer during one meeting and reported information on the developer's behalf. The professional eventually billed the developer for the time related to the comments at the committee meeting and the cost was certified for reimbursement by the TIF Commission.<sup>35</sup> When an individual represents more than one entity, it could create a potential conflict of interest and could make it more difficult to identify on whose behalf a representative is advocating.

**Advisory committee membership benefits members.** The minutes for the 11<sup>th</sup> Street advisory board show the committee recommending funding for projects in which committee members have direct or indirect interests or associations. In recommending one round of development awards, the committee agreed to some grant recommendations before the request for proposals was issued. In the same award round, the committee awarded significantly higher awards than grant applicants

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<sup>33</sup> A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

<sup>34</sup> Advisory committees were authorized by plans approved by the City Council for the 11<sup>th</sup> Street Corridor, Shoal Creek, Chouteau I-35, and KCI Corridor plans. The Chouteau I-35 advisory committee was not active in fiscal year 2002.

<sup>35</sup> Shoal Creek advisory committee meeting minutes, January 24, 2002.

requested.<sup>36</sup> Both of these actions raise fairness issues related to the awards process.

**A former chairman of the TIF Commission advised members of one committee on how to meet requirements but avoid meaningful public participation.** Meeting minutes for the KCI Corridor advisory committee record a former chairman of the TIF Commission offering advice on how to expand a TIF project in order to expend leftover bond proceeds. The meeting minutes record that he advised the committee to “publish a notice that you intend to modify the project description and then hold the hearing that no one but you attend. You then amend the project description to include what you want to spend the money on.”<sup>37</sup>

The City Council should evaluate the benefit of tax increment financing advisory committees/boards.

### **Basic Budget Control Is Missing**

The Commission operates without a budget. A budget provides basic controls over the management of the money flowing in and out of an entity. Budgets determine how resource inflows will be generated and how resource outflows will be allocated or applied. Budgets determine that all conditions for the application of resources have been met.

A budget is a tool for internal and external communication of an entity’s goals and objectives. Budgets also serve as a benchmark against which actual performance can be measured. As early as 1991, the Director of City Planning and Development, which oversees the contract between the city and the Commission, requested that the Commission submit an annual budget.<sup>38</sup>

The President and Chief Executive Officer of the Economic Development Corporation should submit an annual TIF Commission budget as a part of the yearly EDC contract with the city.

### **Management Is Responsible for Internal Controls**

Public managers are accountable for effectively and efficiently using the resources committed to their care. Internal controls are the basic management techniques that establish how an organization conducts its business. Since management alone is in the position to both establish and maintain internal controls, it is management that must be held

<sup>36</sup> 11<sup>th</sup> Street advisory board meeting minutes, February 19, 1999.

<sup>37</sup> KCI Corridor advisory committee meeting minutes, September 25, 2002.

<sup>38</sup> Memorandum from Director of City Planning and Development to the Tax Increment Financing Commission, August 30, 1991.

primarily accountable for their proper functioning. The governing board, however, is ultimately responsible for ensuring that management fulfills its duty to establish the framework of a sound and comprehensive internal control system in order to achieve the organization's objectives.<sup>39</sup>

**TIF Commission management does not communicate the importance of internal controls.** For control procedures to be effective, employees must view the controls as an essential and integral part of the process of providing services to citizens. The Commission management's recent disregard of an external auditor's recommendation concerning staff certification of developer reimbursement requests as well as other certification process practices demonstrates a lack of support for internal controls and sends a message to staff that internal controls are not important.

The key to a favorable control environment is management's attitude and actions. Management must communicate its support for internal controls to staff at all levels in order for controls to be effective. Management must lead by example, creating a "tone at the top" that sets the standard for the entire organization.<sup>40</sup> When management believes that internal controls are important and communicates that belief to employees, internal controls are likely to function well. Likewise, if management sees internal controls as unrelated to achieving its objectives, or even as an obstacle, this attitude will be communicated to staff at all levels, despite official statements or policies to the contrary. The "tone at the top" is the most important element in establishing the effectiveness of internal controls.

**Reliance on the memory of an individual is not consistent with a favorable control environment.** Administration of 42 unique plans and additional projects is a complex process. The memory of one Commission staff member is used as the final authority for many decisions. The current practice of relying on the memory of one staff member to know the various requirements of each plan and agreement is a poor practice and does not adequately protect the public's interests. The memory or personal understanding of a single staff member should not be used to override or replace written procedures and agreements. Consistency and continuity are enhanced when written policies, procedures, and agreements are used as the basis of actions.

**The fiduciary responsibility of managers to represent the public interest is not always applied.** Key staff members' actions in reviewing

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<sup>39</sup> *Evaluating Internal Controls, A Local Government Manager's Guide*, pp. 1-6.

<sup>40</sup> *Evaluating Internal Controls, A Local Government Manager's Guide*, p. 13.

developer requests for reimbursement were not always consistent with their fiduciary responsibility to protect the public's interest. Instead, some decisions appear to benefit the development community rather than the public. While an orientation to satisfy demands made by developers and their representatives explains some decisions that have been made, it has resulted in inadequate protection of the public interest.

### **Critical Controls Must Be Established or Administration Moved**

Despite previous recommendations from this office and its own external auditor, the TIF Commission has not established basic internal controls to safeguard, manage, and account for public dollars for which it is responsible. Immediate actions need to be taken to correct the conditions identified in this audit.

In order to increase oversight of TIF Commission activities, the City Manager should include provisions in the city's annual contract with the Economic Development Corporation that require the establishment of an internal control system adequate to protect the interests of the public and implementation of the recommendations contained in this report. If the TIF Commission and EDC are unable to develop an internal control system adequate to protect the public's interests, the City Council should consider providing administrative support to the TIF Commission through city departments.

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## **City Council Should Address Policy Issues**

Some of the redirected tax dollars that flow through the TIF Commission have been authorized to pay for items that do not clearly advance a public purpose. Some developer agreements require that the Commission pay interest on certified but unpaid expenses without regard to the revenues generated. Public moneys are used to pay for professionals representing individual developers' interests, not public interests. About \$1.4 million in return on equity appears to have been certified as a development expense. In addition, the public's potential financial obligation for TIF projects can be increased without the review and approval of elected officials.

### **Contracts Authorize Interest Payments to Some Developers**

The Commission paid approximately \$21,200 in interest to two Shoal Creek developers in fiscal year 2002.<sup>41</sup> Some Shoal Creek developer agreements with the Commission contained provisions that authorized

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<sup>41</sup> As of August 7, 2003, the total interest paid to two Shoal Creek developers had risen to almost \$162,000.

the payment of interest on expenses that were certified by the Commission but not paid within seven days of certification.

In addition, four current and potential developers signed a prioritization agreement, which established the order of payment among Shoal Creek development projects and provided for the payment of interest on unpaid but certified costs. The Commission has not reimbursed some certified expenses for certain Shoal Creek developers, because monies are held to reimburse other developers who have a higher priority, but have not submitted expenses.

The City Council should examine and offer policy direction to the TIF Commission on the practice of contracting to pay interest to some developers on certified but unpaid costs.

### **Public Benefits of Soft Cost Reimbursements Unclear**

In fiscal year 2002, all of the \$397,000 certified for the Southtown TIF Plan were for staff time and professional services. Almost \$231,000 of these costs were for developer staff time although no documentation was submitted identifying the specific activities developer staff performed to support the reimbursement. About \$88,000 was also certified to reimburse the developer for fees paid to an attorney to assist with real estate transactions within the plan area.

While developers incur and pay expenses related to their business operations, it is not always clear, even to the Commission, which developer expenses should be reimbursed. The Commission, only after some discussion, agreed that expenses incurred by the Southtown TIF Plan developer for hiring a consultant to assist in organizing and gathering information related to economic activity tax information would be considered reimbursable in this instance.<sup>42</sup> Although developers have EATs information gathering responsibilities, \$54,385 was reimbursed to the developer for this activity.

**Developers' legal representatives are paid with public moneys.** In fiscal year 2002, almost \$637,000 in developer legal fees was certified for reimbursement within the eight plans reviewed. A single law firm, representing three developers, accounted for more than 40 percent of this total.

When a professional employed by a developer goes to a Commission meeting or an advisory committee meeting, the public pays for the professional's time. When the Commission's legal counsel talks with the

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<sup>42</sup> Tax Increment Financing Commission meeting minutes, February 9, 2000.

developer's legal counsel, public moneys pay for both sides of the conversation.

The benefit to the public of developers' legal representation is not always apparent. In one instance, legal costs incurred during negotiations for assigning development rights and responsibilities from one developer to another were submitted for reimbursement.<sup>43</sup> Although the Commission questioned the public benefit of paying these legal fees, reimbursement was approved based on a contractual obligation contained in an assignment and assumption agreement, which the Commission's legal counsel had helped develop.

The City Council should examine and offer policy direction to the TIF Commission on the reimbursement of developers' professional service expenses.

### **TIF Commission Guarantee of Return on Equity Is Not Clear**

A sentence and pro forma exhibits in the Chouteau plan documents appear to have been the basis for establishing the TIF Commission's obligation to pay \$1.4 million as a return on equity. However, it is not clear that there is a contractual basis for this payment.

The second paragraph of Section X of the original plan contains one sentence that reads: "With TIF financing, the estimated cash-on-cash returns on equity for these Redevelopment Project Areas is 7.74 percent in Year 1 and 9.82 percent in Year 2." Within the plan documents the only other references to 9.82 percent are found in full closing pro-forma exhibits. It appears that the \$1.4 million payment was not to reimburse the developer for interest expenses paid, but to provide the developer a 9.82 percent return on equity for the project.

**Plan language does not establish an obligation.** Commission staff did not agree that the plan language established an obligation to guarantee a 9.82 percent return on investment to the developer. An e-mail between a current and a former Commission staff member said that the developer's attorney and a member/manager of the developer's LLC refer to the 9.82 percent calculations "as their 'guaranteed' rate of return and have translated that into the interest rate they should receive on the certified costs. I don't think that number was ever negotiated as part of the development agreement, or was ever specifically referenced in relation to interest costs, they just interpreted their 'but for' results as the level of

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<sup>43</sup> Tower plan, project H.

return they should receive on everything related to the project, including carrying costs.”<sup>44</sup>

Other portions of Chouteau plan documents specifically state that the parties recognize that “the ongoing profitability of the Plan is based upon projections that may or may not be fulfilled.”<sup>45</sup> The plan and the development agreement go on to provide for potential public participation in project returns in excess of 17 percent, envisioning public participation, not public subsidy of the developer’s return on equity.

The developer’s attorney, in a March 2001 memo to a Commission consultant explaining the 9.82 percent return on certain expenses, states, “In requesting the changes to the TIF reimbursement, I have changed the methodology of the reimbursement concept.”<sup>46</sup> This is well after the plan was approved by the City Council (April 1998) and a few months after the outside certifier questioned and did not certify “interest accrual” because the interest costs “are not actual expenditures incurred by the developer. The developing company has accrued interest related to a financing agreement from one of the members in the company.”<sup>47</sup>

In December 2002, an attorney for the developer offered a further explanation of the 9.82 percent return. “The agreement was that Chouteau would receive a 9.82 percent return. The concept was that the loan from Fleming was an internal crediting rate and was not necessarily a borrowing. Fleming could easily have treated the entire amount as a capital contribution, should they have desired. Therefore, since it is an inter-party transaction, it should be treated as equity.”<sup>48</sup>

The City Manager should direct the City Attorney to examine the basis of the \$1.4 million “interest” payment for the Chouteau plan to determine whether a contractual obligation existed. Repayment should be sought if appropriate. In addition, the City Council should examine and offer policy direction to the TIF Commission on the use of public money to pay a return on equity.

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<sup>44</sup> E-mail from a former TIF Business Development Officer to the TIF Financial Coordinator, November 5, 2002.

<sup>45</sup> Chouteau TIF Plan, April 15, 1998, IV, Financing, paragraph F, Public Participation in Plan’s Success, p. 10. The September 1998 development agreement contains similar language at page 16, “the parties recognize that the ongoing profitability of the Redevelopment Projects to the Redeveloper are based upon projections that may or may not be fulfilled.”

<sup>46</sup> Memorandum from developer’s attorney to a Commission consultant, March 7, 2001.

<sup>47</sup> Chouteau I-35 Development, LLC Cost Certification 4/23/1998 – 10/20/2000, submitted by cost certifier November 5, 2000, Exhibit C, item 8.

<sup>48</sup> Letter from developer’s attorney to the Commission’s Executive Director, December 6, 2002.

### **Financial Obligations Increased without City Council Approval**

Commission actions have increased the public's potential financial obligations without review or approval by the City Council. The Commission has approved developer reimbursements in excess of the City Council approved plan budgets. City Council review and approval is not obtained when plan budgets are changed or increased, sometimes substantially.

**Commission increased the public's costs.** In November 1997, the Commission approved a budget for a parking garage project in the Tower plan. The developer estimated the project's cost at almost \$8.7 million.<sup>49</sup> In December 1998 the City Council passed an ordinance approving the project based upon the \$8.7 million budget projection.

After the parking garage was constructed, the developer's reimbursement request was for \$11.9 million – exceeding the approved budget by approximately 37 percent. The developer's costs were certified in fiscal year 2002. In a letter chastising the Commission for a lack of written rules and guidelines, the developer wrote that “I believe our obligation was to build a garage, not to build a garage within a certain budget.”<sup>50</sup>

The Commission has directed staff to institute controls for developer cost overruns. However, the ability of the Commission to increase the public's potential financial obligation for redevelopment costs without consultation with elected officials is troubling.

**Certified costs also included business operating equipment and supplies.** Modifications to budgets after the fact may allow the reimbursement of developer business expenses that were not approved by the City Council.

The Commission approved more than \$220,000 for reimbursement of business supplies and equipment for the Tower parking garage.<sup>51</sup> The reimbursement covered the purchase and installation of gates and a booth, card readers, and related microcomputer software. These expenses were not included in the budget.

The City Council should examine and offer policy direction to the TIF Commission on how increases in the public's financial obligations should be incurred.

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<sup>49</sup> Tax Increment Financing Commission meeting minutes, November 12, 1997.

<sup>50</sup> Letter from Tower plan developer to TIF Chairman, July 13, 2001, p. 2.

<sup>51</sup> Tower plan, project A.

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## It Is Not Clear What TIF Funds Have Purchased

Missing and inadequate documentation limit the information that is available to identify what was purchased with the redirected tax dollars that flowed through the Commission's special allocation fund or from bond proceeds. The lack of standard reimbursement categories and coding within the accounting system limit the accessibility and usefulness of information. The transfer of Commission operating funds to the EDC for general expenses rather than to pay for specific expenses also limits information on what is purchased with TIF moneys.

### About \$31.9 Million Distributed in 2002

The Commission staff oversaw the payment of more than \$24 million in redirected tax dollars from the Commission's special allocation fund (SAF) in fiscal year 2002. An additional \$7.7 million in bond proceeds was also disbursed in fiscal year 2002. Almost \$22.7 million went to pay developer expenses and another \$6 million went to debt service. More than \$1 million was returned to taxing jurisdictions and another million was transferred to the Commission's own account as an administrative fee, or to cover specific expenditures. About \$357,000 was paid for services related to bond issuances. (See Exhibit 3.)

Exhibit 3. SAF Payments and Bond Disbursements, Fiscal Year 2002

Payments & Disbursements	Amount	% of Total
Developer Reimbursements and Expense Payments	\$22,696,713	71.1%
Debt Service	6,279,607	19.7%
Taxing Jurisdictions	1,448,717	4.5%
TIF General Operating Account	1,121,123	3.5%
Bond Issuance Fees	357,273	1.1%
Total Payments & Disbursements	\$31,903,433	100.0%

Sources: EDC Accounting Records and Bond Files.

### What TIF Funds Purchase Is Not Clear

Control weaknesses in the certification process and limited information available from the accounting system make it difficult to identify what developers and the Commission have purchased with the redirected tax dollars that flow through the Commission and bond proceeds distributed through trustees. Adequate documentation is not available to support the expenditure or reimbursement of many transactions, and expenditure classifications within the accounting system are not adequate to track and categorize expenditures. In addition, bond disbursement transactions are not tracked in the accounting system.

**Documentation is insufficient.** Developer certification requests and supporting documentation is not complete. Bond disbursements are not consistently supported by documentation. Poor records and weak administration limit the information that can be used to identify and classify legitimate developer expenditures and bond disbursements. The improper certification of some developer expenses further complicates this task.

**Bond disbursements are not systematically tracked.** Despite the large amount of bond proceeds being disbursed, bond disbursement information on developer expenses is not in the accounting system or systematically tracked. The Commission's only records for some of these transactions are documents in notebooks maintained by the TIF director.

**Developer reimbursement categories are not used in the accounting system.** Categories have not been established to track the various types of developer expenses reimbursed with redirected tax dollars and bond proceeds. Past representations by the Commission that "more than 70% of the TIF reimbursements go for costs associated with public infrastructure...and another 24% go to constructing parking"<sup>52</sup> are not based on an examination of specific costs and appear to overstate the construction value of projects.

Although the Commission reimburses and pays developer expenses, the lack of categories in the accounting system makes it difficult to summarize and analyze expenditures. The Commission's representations of infrastructure and project construction expenditures are based on the total moneys expended. Soft costs such as marketing and legal fees are included as infrastructure based on assumptions that all expenses related to a project go for infrastructure. A more accurate representation of what has been purchased with TIF monies could be obtained if the Commission used the accounting system to segment and report TIF related expenditures.

The President and Chief Executive Officer of the Economic Development Corporation should use the EDC's automated accounting system to track and develop information to report to the Commission and others.

**Construction costs represent more than half of selected reimbursement requests.** While it is not possible to definitively identify what TIF paid for during fiscal year 2002, a review of the documentation used to certify developer costs or as support for bond disbursements offers a general view of plan expenses. Based on developer submissions and available bond issuance information, 55

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<sup>52</sup> Memorandum from the TIF director to the Chairman of the Finance and Audit Committee, July 10, 2002, p. 2.

percent of expenses were for construction and demolition costs; more than 13 percent for environmental reclamation and remediation; 10 percent for professional services; and about 9 percent for developer interest, financing, and return on equity. (See Exhibit 4.)

Exhibit 4. Developer & Bond Expenses Submitted for Payment, FY 2002

Type of Expense	Percentage
Construction & Demolition	55.0%
Environmental Reclamation & Remediation	13.6%
Professional Services	10.0%
Developer Interest, Financing & Return	9.2%
Purchase Land & Equipment	5.9%
Project Management & Developer Staff	2.3%
TIF Bond Interest	1.9%
Investment Banking & Trustee Fees	1.1%
TIF & EDC Charges	0.6%
Tenant Relocation Expense	0.4%
Total	100.0%

Sources: TIF Commission records on costs submitted for reimbursement, Fiscal Year 2002.

**More than \$1 million of TIF general operating fund transfers support unspecified EDC expenses.** Approximately \$1.1 million in redirected tax dollars were transferred to the Commission's general operating fund in fiscal year 2002 from the special allocation funds. Of that, more than \$1 million was transferred from the TIF general operating account to the EDC. In fiscal year 2002, Commission transfers of \$50,000 to \$100,000 went to support the EDC about once or twice a month. Although some transfers between the Commission and the EDC are based on specific expenditures or allocations, almost 60 percent of the TIF general operating account payments made in fiscal year 2002 were based only on the Commission's ability to support the EDC, not to cover specific TIF-related expenditures. (See Exhibit 5.)

Exhibit 5. TIF General Operating Account Payments, Fiscal Year 2002

Type of Expense	Amount	Percentage
EDC Undocumented Expenses	\$1,025,000	59.1%
Professional Services	356,636	20.6%
Loan to Developer	235,301	13.6%
City Staff Time <sup>53</sup>	70,469	4.1%
Miscellaneous Business Expenses	47,425	2.7%
Total	\$1,734,831	100.0%

Sources: TIF Commission General Operating Fund Check Register and EDC invoicing.

<sup>53</sup> The Commission contracts with the city's Human Relations Department to monitor developer compliance with the Commission's Affirmative Action policy. The Commission also contracts with the city's Finance Department for work related to PILOTs and EATs administration.

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## **Changes in City Policies Should Be Adopted by TIF**

Recently the City Council approved two changes that should be noted and incorporated into the TIF Commission's operations. The city limited bond issuance costs and raised the portion of street construction fees due from property developers.

### **Ceiling for Bond Issuance Costs Should Be Followed**

The TIF Commission does not have a specific policy regarding limits on professional services expenses related to bond issuances. In 2003, the City Council adopted a resolution<sup>54</sup> establishing target ceilings for bond issuance costs for development-related projects that are backed by the city's guarantee. The EDC was an important contributor to the process of drafting and adopting this resolution. The ceilings range from 2 to 3 percent based on the aggregate par amount of the bonds issued. The resolution also requires that information on professional services related to the financing of development projects be submitted for consideration and approval when the bond issue is presented to the City Council for consideration.

TIF projects are sometimes financed with bonds. Development expenses and issuance expenses are paid out of bond proceeds, and redirected tax dollars obtained from PILOTs and EATs are used to repay the debt. Although the TIF Commission staff has issued requests for qualifications for professional service providers for bond issuance work, written contracts that define the scope of work and cost of the service have not been used.

The President and Chief Executive Officer of the Economic Development Corporation should direct staff to follow the requirements of Second Committee Substitute for Resolution 020238 and expand the scope of this resolution to apply to all TIF-related bond issues, and identify and report to the TIF Commission projected bond issuance expenses for all TIF-related issues.

### **New Street Improvement Rates Should Be Adopted**

The city recently revised the share of street construction costs that developers pay. Ordinance 030233 increased the base share from the 1991 level of \$134 per linear foot to \$200 per linear foot on collector or local street classifications. The new base amount can be adjusted up or

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<sup>54</sup> Second Committee Substitute for Resolution 020238.

*Performance Audit: Controls Over TIF Expenditures*

down when constraints or conditions dictate. The City Manager also has the authority to adjust the rate based on the consumer price index. In addition, Ordinance 020427 and Ordinance 011258 established developer obligations related to arterial street improvements. These ordinances establish methods for determining developer obligations for street and roadway improvements using the city's current estimates of construction costs.

Some TIF agreements contain provisions that require developers and property owners within a TIF plan area to contribute a share of construction costs for street and roadway improvements. This share has been based on the 1991 level of \$134 per linear foot. Commission staff should consult with the city's Public Works Department to determine construction cost estimates at the time agreements are executed. The President and Chief Executive Officer of the Economic Development Corporation should ensure that future TIF agreements reflect the most recent contribution levels established by the city.

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## Recommendations

1. The President and Chief Executive Officer of the Economic Development Corporation should establish procedures to systematically identify and promptly pay obligations due to taxing jurisdictions.
2. The President and Chief Executive Officer of the Economic Development Corporation should adopt a method of allocating incidental costs among plans. Plan revenues taken by the Commission should be documented and attributable to a particular plan. Incidental expenses allocated under a method adopted by the Commission should also be documented.
3. The President and Chief Executive Officer of the Economic Development Corporation should employ outside certifiers to review documentation of previously certified costs and obtain additional supporting documentation where needed. Reimbursements should be tied to specific expenditures under the terms of written agreements. Certifications should be revised in those instances in which expenses are not allowed by state statute, required by the terms of the plan and executed contracts, or documentation is not provided. Unsupported, duplicate, and ineligible reimbursements that have been paid should be recovered and repaid to the special allocation fund.
4. The President and Chief Executive Officer of the Economic Development Corporation should ensure that written agreements are executed before moneys are paid.
5. The President and Chief Executive Officer of the Economic Development Corporation should ensure that state law is followed and execute and maintain copies of all Commission contracts. Contract terms should be established in writing and followed.
6. The President and Chief Executive Officer of the Economic Development Corporation should direct staff to update current policies governing the Commission's professional services contracting and establish standards for documentation required to support billing for professional services.
7. The President and Chief Executive Officer of the Economic Development Corporation should ensure that commission and committee minutes are complete and accurate, and that copies of minutes are maintained.

8. The President and Chief Executive Officer of the Economic Development Corporation should ensure that all cost certifications are conducted by independent reviewers.
9. The President and Chief Executive Officer of the Economic Development Corporation should ensure that copies of executed agreements and contracts are maintained in a systematic manner and are used to identify obligations and serve as the basis for reimbursements.
10. The President and Chief Executive Officer of the Economic Development Corporation should prepare for Commission adoption a policy identifying the documentation that developers are required to submit for certification of reimbursable expenses and establish a standard method of organizing the submission for all certifications.
11. The President and Chief Executive Officer of the Economic Development Corporation should establish a procedure describing how independent reviewers will conduct examinations of reimbursable expenses. Documentation submitted by developers and those administering the program should be maintained in a systematic manner and be available for future examination.
12. The President and Chief Executive Officer of the Economic Development Corporation should develop a system to track and enforce all developer obligations.
13. The President and Chief Executive Officer of the Economic Development Corporation should ensure that bond disbursement requests are brought before the TIF Commission and that the certification of the expenses authorized for disbursement are reviewed by an outside reviewer.
14. The President and Chief Executive Officer of the Economic Development Corporation should submit an annual TIF Commission budget as a part of the yearly EDC contract with the city.
15. The President and Chief Executive Officer of the Economic Development Corporation should use the EDC's automated accounting system to track and develop information to report to the Commission and others.

16. The President and Chief Executive Officer of the Economic Development Corporation should direct staff to follow the requirements of Second Committee Substitute for Resolution 020238 and expand the scope of this resolution to apply to all TIF-related bond issues, and identify and report to the TIF Commission all projected bond issuance expenses.
17. The President and Chief Executive Officer of the Economic Development Corporation should ensure that future TIF agreements reflect the most recent street construction contribution levels established by the city.
18. The City Manager should include provisions in the city's annual contract with the Economic Development Corporation that require the establishment of an internal control system adequate to protect the interests of the city and implementation of the recommendations contained in this report.
19. The City Manager should direct the City Attorney to examine the basis of the \$1.4 million "interest" payment for the Chouteau plan to determine whether a contractual obligation existed. If appropriate, the City Manager should seek repayment.
20. The City Council should evaluate the role of tax increment financing advisory committees/boards.
21. The City Council should offer direction to the TIF Commission on policy issues related to eligible reimbursable expenses. The City Council should specifically address interest and return on equity payments to developers, professional services expenses of developers, and increases in the public's potential financial obligations without City Council review.
22. The City Council should consider providing administrative support to the TIF Commission through city departments if the Economic Development Corporation is unable to develop an internal control system adequate to protect the public's interests.



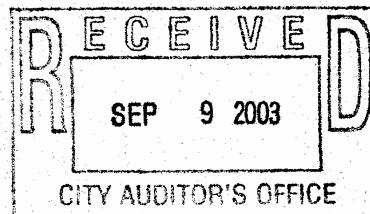
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## **Appendix A**

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### **President and Chief Executive Officer of Economic Development Corporation's Response**





September 2, 2003

Mark Funkhouser, City Auditor  
21<sup>st</sup> Floor, City Hall  
414 East 12<sup>th</sup> Street  
Kansas City, Missouri 64106

Dear Dr. Funkhouser:

I am in receipt of the draft Performance Audit of Controls over TIF Expenditures dated August 15, 2003. I have spent considerable time reviewing the recommendations set forth in the document.

On behalf of the Tax Increment Financing Commission and the Economic Development Corporation of Kansas City, Missouri, I would extend our appreciation for the recommendations presented in this audit. Additionally, I would also compliment the audit staff for their level of professionalism while conducting the audit.

I am in agreement with the findings and recommendations presented. Many of these same recommendations were presented to me by our own external auditors, Cochran, Head & Company. As a result of their recommendations, the process of implementing the solutions has already begun.

Attached are descriptions of several areas in which the work has begun. You will notice that your audit recommendations have been tied to these projects that are already in process.

It is my understanding that the audit is scheduled to be presented before the City Council's Budget and Audit Committee on Tuesday, September 23, 2003. Should you have any questions regarding this attached document, please do not hesitate to contact me at 691-2105.

Sincerely,

Andi Udris  
President & CEO  
Economic Development Corporation of  
Kansas City, Missouri

ECONOMIC DEVELOPMENT CORPORATION OF KANSAS CITY, MISSOURI

10 PETTICOAT LANE ■ SUITE 230 ■ KANSAS CITY, MISSOURI 64108-2103 ■ 816-221-0636 ■ FAX 816-221-0189 ■ 800-889-0636  
INTERNET: <http://www.edckc.com> ■ E-mail: [edckc@edckc.com](mailto:edckc@edckc.com) or 73531.625@compuserve.com

## PROJECT MANAGEMENT

### Solutions:

Total overhaul of the records management system will be undertaken. The updated system will be technology driven.

Three main software programs will be implemented: **Case Management, Document Management, and an Imaging solution.**

**Case Management** software is widely used by law firms, accounting firms, real estate firms and in healthcare settings. Program begins with a file index and includes such fields as name, address, contact person and other pertinent data for easy access. These fields can later be used in a report writer function.

**Case Management** includes a calendaring/tickler system to set up various tasks that must be completed for a file such as securing funding agreements, redevelopment agreements, or annual reporting requirements. Ongoing task list, interfaced with calendar, is generated and task remains open until completed.

**Case Management** includes an extensive contacts data base. File notations will be accommodated within the system. Saved e-mails of importance will be housed within the system.

**Case Management** will be linked with Great Plains Time and Billing system for better tracking of time spent on a specific TIF plan.

**Document Management** system is being implemented to enhance search capabilities within records systems. Documents will be full-text indexed. Documents can be searched based upon key words, author, type of document, agency, plan, or project.

**Imaging Solution** will be implemented so that documents not generated within EDC system can be brought into the computer system for retention. This will include documents such as executed legal contracts, correspondence and plan applications.

**Deposit/Disbursement Services** will be contracted to outside service firm such as Wells Fargo Corporate Trust Services. Their superior technology will be utilized for handling SAF and Developer sub-account transactions.

**Deposit/Disbursement Services** implementation will require a complete legal review and summarization of all TIF plans and projects.

### Audit Recommendation #1:

The President and Chief Executive Officer of the Economic Development Corporation should establish procedures to systematically identify and promptly pay obligations due to taxing jurisdictions.

### Audit Recommendation #4:

The President and Chief Executive Officer of the Economic Development Corporation should ensure that written agreements are executed before moneys are paid.

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## COST CERTIFICATIONS

### **Solutions:**

**ALL** cost certifications are to be done by an outside CPA firm.

Bid process will be re-opened to expand the number of CPA firms that are currently utilized for cost certifications.

Establish written policy for submitting cost certifications. Convey policy to CPA firms handling the cost certification process as well as the developers submitting for reimbursement.

CPA firms must certify 100% of documents submitted, not just a sampling percentage.

Any costs that exceed category budget must be brought before TIF Commission for approval and budget amendment.

Hardcopy of cost certification paperwork will be maintained in TIF filing system.

Cost certification paperwork will be scanned into computer system for easy access and for comparison purposes.

**NO** payments to developers or expenses will be incurred until certification paperwork or executed documents are in the file system.

All reimbursements processed since 1998 will be reviewed for accuracy and necessary adjustments made.

EDC Finance Department will be involved in all cost certifications to ensure separation of duties and adequate controls.

### **Audit Recommendation #3:**

The President and Chief Executive Officer of the Economic Development Corporation should employ outside certifiers to review documentation of previously certified costs and obtain additional supporting documentation where needed. Reimbursements should be tied to specific expenditures under the terms of written agreements. Certifications should be revised in those instances in which expenses are not allowed by state statute, required by the terms of the plan and executed contracts, or documentation is not provided. Unsupported, duplicate, and ineligible reimbursements that have been paid should be recovered and repaid to the special allocation fund.

### **Audit Recommendation #8:**

The President and Chief Executive Officer of the Economic Development Corporation should ensure that all cost certifications are conducted by independent reviewers.

### **Audit Recommendation #10:**

The President and Chief Executive officer of the Economic Development Corporation should prepare for Commission adoption, a policy identifying the documentation that developers are required to submit for certification of reimbursable expenses and establish a standard method of organizing the submission for all certifications.

**Audit Recommendation #11:**

The President and Chief Executive Officer of the Economic Development Corporation should establish a procedure describing how independent reviewers will conduct examinations of reimbursable expenses. Documentation submitted by developers and those administering the program should be maintained in a systematic manner and be available for future examination.

## **BOND ISSUANCES**

**Solutions:**

Involve EDC Finance Department throughout bond negotiation process.

**ALL** costs must be certified prior to closing and each subsequent bond draw. This would include items such as bond issuance fees, legal fees, etc. that usually come out at closing.

Establish bid process for professional services resulting in signed contracts detailing fee structure.

Adhere to City guidelines for costs of bond issuance.

Bond draw requests to trustee must have signatures of COO of TIF, EDC Controller and EDC Finance/Administrative Officer.

Track and record, in TIF financial statements, all transactions involved with bonds including closing schedules, bond draws, and debt service.

Address debt service issue whereby payment is made without supporting certified costs.

EDC Finance Department to be involved in all bond transactions to ensure separation of duties and adequate controls.

**Audit Recommendation #13:**

The President and Chief Executive Officer of the Economic Development Corporation should ensure that bond disbursement requests are brought before the TIF Commission and that the certification of the expenses authorized for disbursement are reviewed by an outside reviewer.

**Audit Recommendation #16:**

The President and Chief Executive Officer of the Economic Development Corporation should direct staff to follow the requirements of Second Committee Substitute for Resolution 020238 and expand the scope of this resolution to apply to all TIF-related bond issues, and identify and report to the TIF Commission all projected bond issuance expenses.

## BUDGET PROCESS

### **Solutions:**

Establish a 5 year history of PILOTS and EATS collections and payments.

Expand the budget compiled as a result, to use as a five year forecast.

Maintain budget by project in Great Plains Accounting System.

Report on variances on a quarterly basis.

Establish a budget for developer expenses at beginning of project. Any variances noted throughout the project would need explanation to TIF Commission and approval.

Maintain a history of average costs of expenses associated with a TIF plan.

Establish a detailed, annual budget for TIF general expenses with review by TIF Finance Committee and EDC Executive Committee.

Budget versus Actual variances will be reported on a monthly basis to the TIF Commission.

### **Audit Recommendation #14:**

The President and Chief Executive Officer of the Economic Development Corporation should submit an annual TIF Commission budget as a part of the yearly EDC contract with the City.

## **ANNUAL REPORT**

### **Solutions:**

Internally compile as much information as possible, going to developer for confirmation of information.

On going maintenance of report particulars to be kept in case management package.

Maintain pictures of each project in EDC computer system for inclusion in annual report.

Annual report submitted to State and City should balance to EDC accounting records and not just be for informational purposes.

Annual meeting with developers, at time of report preparation, to verify information and review TIF policies and procedures.

As part of annual report preparation and developer meeting, require the developers to provide complete listing of businesses within their TIF area.

At annual developer meeting, developers will be required to complete Public Participation Report as required by TIF plans.

Eliminate printing costs of annual report by publishing report on CD with minimal copies printed on in-house copier.

### **Audit Recommendation #12:**

The President and Chief Executive Officer of the Economic Development Corporation should develop a system to track and enforce all developer obligations.

## WHAT DO TIF DOLLARS PAY FOR ?

### **Solutions:**

Detail usage of 5% Administrative Fee that is captured by the TIF Commission.

Detail time associated with EDC employees working on TIF projects through extended usage of Great Plains Timekeeping package.

Categorize certified and reimbursed expenses utilizing automated accounting system.

Maintain the tracking of reimbursed certified costs in the Great Plains Accounting system. Report-writer function would be used for compilation of total, across all TIF plans, of exactly what the reimbursed TIF dollars have paid for, by established categories.

### **Audit Recommendation #2:**

The President and Chief Executive Officer of the Economic Development Corporation should adopt a method of allocating incidental costs among plans. Plan revenues taken by the Commission should be documented and attributable to a particular plan. Incidental expenses allocated under a method adopted by the Commission should also be documented.

### **Audit Recommendation #15:**

The President and Chief Executive Officer of the Economic Development Corporation should use the EDC's automated accounting system to track and develop information to report to the Commission and others.

## **TIF FILES & FILE ROOM**

### **Solutions:**

Establish record retention schedule for all agencies.

Send older files to off-site storage.

Install high density filing system in current file room to expand capacity.

All files will be reorganized and cross-referenced to case management system, including search for and replacing missing documents.

At completion of reorganization the paper files will match the computer files and will ultimately be secured for legal reference only. Computer files will be used for daily reference purposes.

A tape library will be established to house the recording of all meetings held under the provisions of the Sunshine Law.

Integrity of files will be maintained through a bar-coding check in/check out system.

### **Audit Recommendation #5:**

The President and Chief Executive Officer of the Economic Development Corporation should ensure that state law is followed and execute and maintain copies of all Commission contracts. Contract terms should be established in writing and followed.

### **Audit Recommendation #7:**

The President and Chief Executive Officer of the Economic Development Corporation should ensure that commission and committee minutes are complete and accurate, and that copies of minutes are maintained.

### **Audit Recommendation #9:**

The President and Chief Executive Officer of the Economic Development Corporation should ensure that copies of executed agreements and contracts are maintained in a systematic manner and are used to identify obligations and serve as the basis for reimbursements.

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## POLICY REVIEW BY COMMISSION/CITY COUNCIL

### **Solutions:**

Establish policy for Professional Service Contracts to include competitive bid process, signed contracts, and application of City guidelines regarding MBE/WBE contractors.

Review City Council ordinances that may affect TIF for compliance (i.e. 030233—Street construction contribution levels.

### **Audit Recommendation #6:**

The President and Chief Executive Officer of the Economic Development Corporation should direct staff to update current policies governing the Commission's professional services contracting and establish standards for documentation required to support billing for professional services.

### **Audit Recommendation #17:**

The President and Chief Executive Officer of the Economic Development Corporation should ensure that future TIF agreements reflect the most recent street construction contribution levels established by the City.

## ADVISORY COMMITTEES

### Solutions:

Set standard guidelines for all advisory committees.

Establish a policy for committee membership addressing ethics and conflict of interest.

All advisory committees will operate under the Sunshine Law.

Review with all staff members the requirements of the Sunshine Law.

Meetings will be recorded and maintained in EDC tape library. Minutes of the meetings will be taken and maintained by EDC staff member.

Minutes of advisory committee meetings will be included in TIFC agenda package and entered into the record.

Advisory Committee meetings will be conducted as Public Hearings, with proper notice, at the offices of the EDC with a TIF staff member in attendance.

## LAW FIRMS

Require each law firm to sign a standardized engagement letter detailing specific billing requirements such as hourly rates, billing increment, charges for direct costs, etc.

Continue review process of all legal bills for adherence to engagement letters and billing guidelines. Ray Sandy Sutton, retired VP and General Counsel for Interstate Bakeries has been directing these efforts for the EDC.

Work with law firms to standardize TIF contracts. Uniqueness of plan will be addressed by addendums to contracts.

## PILOTS/EATS

Management letter of audit of TIF financial statements cited a reportable condition and a material weakness with regard to the entry of accounts receivable.

The accounts receivable is monies owed to the TIF Commission from the City and subsequently to the developers. This total amount is approximately \$12,000,000.

The accounts receivable represents tax monies that have been received by the City within the TIF areas. The current procedure calls for the developers to submit information including copies of tax returns, utility bills, etc., in order to lay claim to the reimbursement. Once the claim is processed the money is forwarded to the TIF Commission for reimbursement to the developers. Difficulty in filing is one of the prime reasons for the amount of this accounts receivable. A substantial portion of this amount is several years old.

TIF Commission must work in partnership with City Finance to:

- Automate TIF reimbursement process
- Provide a listing of 100% of business within TIF area
- Secure Federal and Missouri Tax ID numbers from all businesses within TIF plan.
- Secure confidentiality release agreement from all businesses within TIF plan.

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## TRAINING

Ensure that all components to initiate TIF plan have been adhered to by member of Finance Department being present at initial meetings.

Initial training for developers to include:

- EDC contact information
- Certification process
- EAT's documentation
- PILOTS
- Accounting issues/SAF reimbursement
- Annual report procedures
- Annual tenant listing
- Public Participation Report

Assist developer in formulating EAT's language in leases so to enforce adherence.

At first EAT's submission, assist developer with issue or questions from tenants.



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## **Appendix B**

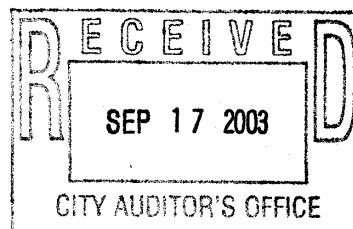
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### **City Manager's Response**





## Office of the City Manager



**Date:** September 17, 2003  
**To:** Mark Funkhouser, City Auditor  
**From:** <sup>WC</sup> Wayne Cauthen, City Manager  
**Subject:** Audit Report: Controls Over TIF Expenditures

The Performance Audit of Controls Over Tax Increment Financing (TIF) expenditures make two recommendations requesting a response by the Office of the City Manager.

### Item (18)

**The City Manager should include provision in the city's annual contract with the Economic Development Corporation that require the establishment of an internal control system adequate to protect the interests of the city and implementation of the recommendations contained in this report.**

### *Response:*

*I concur with this recommendation. Review of the audit indicates that despite previous recommendations from the City Auditor's Office, and despite recommendations from its own external auditors the TIF Commission has failed to establish even basic controls to safeguard and account for the public dollars for which it is responsible. Because of this lack of basic controls, the audit reveals that the TIF Commission cannot even document what it has purchased with redirected tax dollars. What is at issue is the use of public revenues. As an immediate first step my office will instruct the Department of City Development to amend the existing contract with the Economic Development Corporation (EDC) to require the (EDC) to establish an internal control system satisfactory to the city, and to agree to regular monitoring, inspections and tracking by the City. Additionally, I support the Auditor's recommendation that if the TIF Commission fails to agree to this amended contract language, or fails to establish an internal control system satisfactory to the city I will recommend to the City Council that the City Manager's Office provide administrative oversight of the TIF Commission.*

### Item (19)

**The City Manager should direct the City Attorney to examine the basis of the \$1.4 million "interest" payment for the Chouteau plan to determine whether a contractual obligation existed. If appropriate, the City Manager should seek repayment.**

### **Response:**

I concur with this recommendation. My Office will instruct the City Attorney to determine if a contractual obligation existed as outlined in the Audit.